

Letter of Findings Number: 10-0307
Income Tax
For Tax Years 2004-06

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ISSUES

I. Adjusted Gross Income Tax—Liability.

Authority: IC § 6-3-2-1; IC § 6-3-2-2; IC § 6-8.1-5-1; IC § 6-8.1-9-1.

Taxpayer protests the imposition of adjusted gross income tax.

II. Tax Administration—Negligence Penalty and Interest.

Authority: IC § 6-8.1-10-1; IC § 6-8.1-10-2.1; [45 IAC 15-11-2](#).

Taxpayer protests the imposition of ten percent negligence penalties and interest.

STATEMENT OF FACTS

Taxpayer is a corporation. As the result of an audit, the Indiana Department of Revenue ("Department") determined that Taxpayer had under-reported its Indiana adjusted gross income tax ("AGIT") for the tax years 2004, 2005, and 2006. Taxpayer protests that it mistakenly filed Indiana income tax returns for those years and that it does not owe Indiana income tax at all. An administrative hearing was held and this Letter of Findings results. Further facts will be supplied as required.

I. Adjusted Gross Income Tax—Liability.

DISCUSSION

The Department conducted an audit of Taxpayer regarding Indiana adjusted gross income tax for the tax years 2004, 2005, and 2006. The Department determined that royalties which Taxpayer had deducted on its Indiana income tax returns should be added back in order to fairly reflect Taxpayer's Indiana income. Taxpayer protests that it is not subject to Indiana adjusted gross income tax and that the Department's adjustments in the audit are therefore moot. The Department notes that the burden of proving a proposed assessment wrong rests with the person against whom the proposed assessment is made, as provided by IC § 6-8.1-5-1(c).

The adjusted gross income tax is imposed under IC § 6-3-2-1, which states:

- (a) Each taxable year, a tax at the rate of three and four-tenths percent (3.4 [percent]) of adjusted gross income is imposed upon the adjusted gross income of every resident person, and on that part of the adjusted gross income derived from sources within Indiana of every nonresident person.
- (b) Except as provided in section 1.5 of this chapter, each taxable year, a tax at the rate of eight and five-tenths percent (8.5 [percent]) of adjusted gross income is imposed on that part of the adjusted gross income derived from sources within Indiana of every corporation.

Also of relevance is IC § 6-3-2-2, which states in relevant parts:

(a) With regard to corporations and nonresident persons, "adjusted gross income derived from sources within Indiana", for the purposes of this article, shall mean and include:

- (1) income from real or tangible personal property located in this state;
- (2) income from doing business in this state;
- (3) income from a trade or profession conducted in this state;
- (4) compensation for labor or services rendered within this state; and
- (5) income from stocks, bonds, notes, bank deposits, patents, copyrights, secret processes and formulas, good will, trademarks, trade brands, franchises, and other intangible personal property if the receipt from the intangible is attributable to Indiana under section 2.2 of this chapter.

...

(l) If the allocation and apportionment provisions of this article do not fairly represent the taxpayer's income derived from sources within the state of Indiana, the taxpayer may petition for or the department may require, in respect to all or any part of the taxpayer's business activity, if reasonable:

- (1) separate accounting;
- (2) the exclusion of any one (1) or more of the factors;
- (3) the inclusion of one (1) or more additional factors which will fairly represent the taxpayer's income derived from sources within the state of Indiana; or
- (4) the employment of any other method to effectuate an equitable allocation and apportionment of the taxpayer's income.

....

As the result of its audit, the Department determined that the royalties which Taxpayer removed from taxable income on its Indiana returns should be added back to Taxpayer's taxable Indiana income. The Department listed

several factors which led to this conclusion.

Taxpayer protested this determination. At hearing, Taxpayer stated that it should not have been filing combined returns in Indiana and that it did not owe Indiana AGIT at all, let alone the proposed assessments resulting from the royalty addback. Taxpayer states that the auditor erred in treating it as if it were in a unitary relationship with the related entities described in the audit report. Taxpayer provided documentation and analysis in support of the position that it was not in a unitary relationship with these entities.

The Department disagrees with Taxpayer's conclusion. Taxpayer has offered no analysis or documentation to establish that the proposed assessments resulting from the addback of royalties are wrong. Taxpayer has only argued that it erred in filing combined returns. The Department refers to IC § 6-8.1-9-1(a), which states:

If a person has paid more tax than the person determines is legally due for a particular taxable period, the person may file a claim for a refund with the department. Except as provided in subsections (f) and (g), in order to obtain the refund, the person must file the claim with the department within three (3) years after the latter of the following:

- (1) The due date of the return.
- (2) The date of payment.

For purposes of this section, the due date for a return filed for the state gross retail or use tax, the gasoline tax, the special fuel tax, the motor carrier fuel tax, the oil inspection fee, or the petroleum severance tax is the end of the calendar year which contains the taxable period for which the return is filed. The claim must set forth the amount of the refund to which the person is entitled and the reasons that the person is entitled to the refund.

Rather than waiting for the Department to conduct an audit and protesting the resulting proposed assessments, Taxpayer should have diligently reviewed its filing methods and filed refund claims for those years. Taxpayer has made no direct argument regarding the addback of royalties. The Department does not agree that the proposed assessments resulting from the royalty addbacks are moot. For the purposes of this protest, Taxpayer has not met the burden of proving the proposed assessments wrong, as required by IC § 6-8.1-5-1(c). A protest of an audit is not the appropriate forum for Taxpayer's argument. Amended returns and claims for refund are the appropriate forum for Taxpayer's argument.

FINDING

Taxpayer's protest is denied.

II. Tax Administration—Negligence Penalty and Interest.

DISCUSSION

The Department issued proposed assessments and the ten percent negligence penalty for the tax years in question. Taxpayer protests the imposition of penalty and interest. Under IC § 6-8.1-10-1(e), the Department may not waive interest. Next, the Department refers to IC § 6-8.1-10-2.1(a), which states in relevant part:

If a person:

...

(3) incurs, upon examination by the department, a deficiency that is due to negligence;

...

the person is subject to a penalty.

The Department refers to [45 IAC 15-11-2\(b\)](#), which states:

Negligence, on behalf of a taxpayer is defined as the failure to use such reasonable care, caution, or diligence as would be expected of an ordinary reasonable taxpayer. Negligence would result from a taxpayer's carelessness, thoughtlessness, disregard or inattention to duties placed upon the taxpayer by the Indiana Code or department regulations. Ignorance of the listed tax laws, rules and/or regulations is treated as negligence. Further, failure to read and follow instructions provided by the department is treated as negligence. Negligence shall be determined on a case by case basis according to the facts and circumstances of each taxpayer.

[45 IAC 15-11-2\(c\)](#) provides in pertinent part:

The department shall waive the negligence penalty imposed under [IC 6-8.1-10-1](#) if the taxpayer affirmatively establishes that the failure to file a return, pay the full amount of tax due, timely remit tax held in trust, or pay a deficiency was due to reasonable cause and not due to negligence. In order to establish reasonable cause, the taxpayer must demonstrate that it exercised ordinary business care and prudence in carrying out or failing to carry out a duty giving rise to the penalty imposed under this section.

In this case, Taxpayer incurred a deficiency which the Department determined was due to negligence under [45 IAC 15-11-2\(b\)](#), and so was subject to a penalty under IC § 6-8.1-10-2.1(a). Taxpayer has not affirmatively established that its failure to pay the deficiency was due to reasonable cause and not due to negligence, as required by [45 IAC 15-11-2\(c\)](#).

FINDING

Taxpayer's protest is denied.

CONCLUSION

Taxpayer's protest is denied on Issue I regarding adjusted gross income tax. Taxpayer's protest is denied on

Issue II regarding imposition of negligence penalties and interest.

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